Supreme Court, U.S.
FILED

941217 JAN 9 1995

OFFICE OF THE CLERK

No.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1994

GEORGE H. BAKER, SR. and BESSIE J. BAKER,

Petitioners,

v.

THE DEPARTMENT OF REVENUE OF THE STATE OF ILLINOIS, ROGER D. SWEET, Director, and DEPARTMENT OF REVENUE, STATE OF ILLINOIS INCOME DIVISION, JAMES P. PIECZONKA, Administrative Law Judge,

Respondents.

On Petition for Writ of Certiorari to the Appellate Court of Illinois for the Third District

PETITION FOR WRIT OF CERTIORARI

GEORGE H. BAKER, SR.
BESSIE J. BAKER
Petitioners in propria persona
4211 Simpson Drive, Meadowood
Dunlap, Illinois 61525
(309) 243-5212

FEDERAL QUESTIONS PRESENTED

1.

May the Illinois Department of Revenue attach the subject matter jurisdiction and tax the payment received by the inventor in sale of his patent. . . Where all substantial right and interest, including title of ownership, have been assigned to other persons under constitutional federal law and the U.S. Code, Title 35—Patents.

2.

Whether the court of appeals decision has violated due process under federal law. Moreover, has the lower court decided a federal question contrary and in direct conflict with long established U.S. Supreme Court precedents.

TABLE OF CONTENTS

	PAGE
FEDERAL QUESTIONS PRESENTED	i
TABLE OF AUTHORITIES	iii
OPINIONS BELOW	1
JURISDICTION	2
STATEMENT OF THE CASE	2
REASONS FOR GRANTING THE PETITION ..	3
1.	
Reason For Granting This Writ For Review Arise From Gross Judicial Error Relating To The Federal Question Presented.—The Question Was Actually Decided.—And Finally, The Judgment Of The Lower Court Could Not Have Been Rendered But For Clear Judicial Error	3
2.	
The Illinois State Court Of Appeals Has Decided A Federal Question That Is Expressly Clear And In Direct Conflict With Applicable Decisions Of This Court	4
JUDICIAL NOTICE	7
3.	
The Final, But Not Least Reason For Granting This Petition Is That The Court Of Appeals Fails To Find Any Non-Federal And ***Independent And Adequate*** Illinois State Law In Support Of Its Decision	8
CONCLUSION	9
APPENDIX	*infra*

TABLE OF AUTHORITIES

CASES:	PAGE
Army & Air Force Exchange Service v. Sheehan, 456 U.S. 728 (1982)	8
California v. Krivda, 409 U.S. 33 (1972)	9
E.I. du Pont de Nemours and Co. v. United States, 296 F.Supp. 823 (D. Del. 1969), modified, 432 F.2d 1052 (3rd Cir. 1971)	6
Fox Film Corp. v. Doyal, 286 U.S. 123 (1932)	7, 8
Long v. Lockwood, S.C. Reporter's ed. 142-143, 151 (1928)	7, 8
Minnesota v. National Tea Co., 309 U.S. 551 (1940)	9
Powerlift, Inc. v. Weatherford Nipple-Up Systems, 871 F.2d 1082 (Fed. Cir. 1989)	5
Raley v. Ohio, 360 U.S. 423 (1959)	3
Southwestern Bell Tel. Co. v. Oklahoma, 303 U.S. 206 (1938)	3
Waterman v. McKenzie, 138 U.S. 252, 34 L.Ed. 923, 11 S.Ct. 334 (1891)	5, 6, 7, 8

STATUTES:	
35 U.S.C. sec. 152	7
35 U.S.C. sec. 261	5
35 U.S.C. sec. 271	5

RULES:	
37 CFR sec. 3.73	5

IN THE

Supreme Court of the United States

OCTOBER TERM, 1994

GEORGE H. BAKER, SR. and BESSIE J. BAKER,

Petitioners,

v.

THE DEPARTMENT OF REVENUE OF THE STATE OF ILLINOIS, ROGER D. SWEET, Director, and DEPARTMENT OF REVENUE, STATE OF ILLINOIS INCOME DIVISION, JAMES P. PIECZONKA, Administrative Law Judge,

Respondents.

On Petition for Writ of Certiorari to the Appellate Court of Illinois for the Third District

PETITION FOR WRIT OF CERTIORARI

George H. Baker, Sr., discoverer of invention and patentee, respectfully petitions for issuance of a writ of certiorari to the Appellate Court of Illinois for the Third District in this case.

OPINIONS BELOW

In the Illinois Supreme Court the motion to file petition instanter (App., *infra*, A-1) was denied on October

---

Petitioners are Natural persons and United States citizens under Rule 29(1).

13, 1994. The decision of the Appellate Court of Illinois for the Third District (App., B-1 thru B-12) is unreported. The order of the Circuit Court of the Tenth Judicial Circuit of Illinois to affirm the decision of the Department of Revenue (App., C-1 and C-2) is unreported. The Administrative Hearing Officer Decision is not reported (App., D-1 thru D-9).

STATEMENT OF JURISDICTION

The Appellate Court of Illinois entered its judgment on June 30, 1994. Then following, a petition was filed in the "state court of last resort" in the Illinois Supreme Court but denied on October 13, 1994. The jurisdiction considerations of this Court is of the character of substantial reasons under Rule 10.1(c) and further invoked under 28 U.S.C. sec. 2104.

STATEMENT OF THE CASE

1. In this case, George H. Baker, Sr., made a Special Appearance at the Administrative Hearing to challenge the Illinois Department of Revenue jurisdiction over the subject matter. App., D-5, para. (9). The objection points to lack of state jurisdiction to tax any compensation received by the patentee, where by Assignment made transfer to others all ***substantial right, title and ownership*** of his patent issued to him under constitutional federal laws.

2. The Administrative Hearing Officer failed to discern the substantial difference between the sale and transfer, including title ownership, of patent under federal law, from just a mere license under contract law, where patent ownership is ***not*** transferred to the licensee, but instead, is retained by the licensor.

3. Thus, motion to dismiss for lack of jurisdiction over the subject matter was denied. App., D-5, para. (10).

4. This same jurisdictional point came before the trial court on administrative review. The local court Order found that "The decision of the Department of Revenue is not contrary to the law." Such a finding made without a written opinion may be taken as just a handy discretionary procedure used unreasonably to avoid a decision relative to a constitutional federal question of National importance raised by the plaintiff.

5. The constitutional federal question was preserved for appellate review in the Illinois State Appellate Court that accepted such a question, not before, but should be heard. See its decision with opinion. App., B-1 thru B-12.

REASONS FOR GRANTING THE PETITION

1.

Reason For Granting This Writ For Review Arise From Gross Judicial Error Relating To The Federal Question Presented.—The Question Was Actually Decided.—And Finally, The Judgment Of The Lower Court Could Not Have Been Rendered But For Clear Judicial Error.

Southwestern Bell Tel. Co. v. Oklahoma, 303 U.S. 206 (1938); *Raley v. Ohio*, 360 U.S. 423, 434-437 (1959).

Petitioner (Baker) made special appearance at the Administrative Hearing to challenge Department of Revenue to attach jurisdiction to tax the payment received in sale of his patent. . . Where all substantial right to make, use and to vend, including the Title of ownership to his patent have been assigned and transferred to other persons. App., B-4.

The challenge to state jurisdiction to tax property governed by superior federal statutory law under U.S. Code, Title 35-Patents was preserved and thus presented in the Illinois Court of Appeals for review where the objection to jurisdiction over subject matter was overruled:

> "The Baker's first contention is whether the income derived from sale of a patent is subject to State taxation. We determine that the State has the power to tax such income and that this matter was properly before the Department." App., B-5.

2.

The Illinois State Court Of Appeals Has Decided A Federal Question That Is Expressly Clear And In Direct Conflict With Applicable Decisions Of This Court.

The constitutional federal question that is in conflict with applicable decisions of this U.S. Supreme Court points to the principal difference between a sale of patent by assignment under federal law from that distinct difference of a mere license transaction under state contract law. The court below said, relating to a license versus sale of patent:

> "We can discern no principled distinction. . . Regardless of the nature of the agreement by which the patent was used or by whom it was used, the Bakers nevertheless realized income derived from the patent's sale." App., B-6.

The lower court committed gross judicial error for cause of ignoring the well settled principal difference between the absolute sale of patent including Title of ownership to another person from that distinct license contract without transfer of ownership, i.e.,

Patents, like other property rights, provide the owner thereof with a federally mandated monopoly right to exclude. This right to exclude specifically relates to the right to exclude others from making, using, or selling the patented invention. 35 U.S.C. sec. 271. Patent rights can be assigned or licensed by their owners, with certain distinctions between these two types of transfers.

As to ownership of a patent, "[t]he inventor is presumed to be the owner of a patent application, and any patent that may issue therefrom, unless there is an assignment." 37 CFR sec. 3.73. And, pursuant to 35 U.S.C. sec. 261, it is stated, "subject to the provisions of this title, patents shall have the attributes of personal property. Applications for patent, patents or any interest therein, shall be assignable in law by an instrument in writing. . . ."

In an assignment, an assignor transfers ownership rights in a patent, usually by sale, to the assignee. To determine whether an assignment has occurred, the rights transferred and retained by the assignor must be examined. A patent licensor retains the ownership rights, and therefore the title, of patent. Generally, in a patent license, the licensee obtains the right to infringe, i.e., to not be sued for making, using, or selling that which is covered by the patent. Since a license is a contract, "it is governed by ordinary principles of state contract law." *Powerlift, Inc. v. Weatherford Nipple-Up Systems*, 871 F.2d 1082, 1085 (Fed. Cir. 1989) (citation omitted).

At times there can arise questions as to whether a certain transaction is an assignment or a license. In *Waterman v. McKenzie*, 138 U.S. 252, 34 L.Ed. 923, 11 S.Ct. 334 (1891), the Court found that a patent license is any transfer of intellectual property rights which does not amount to an assignment:

> The patentee or his assigns may, by an instrument in writing, assign, grant and convey, either (1st) the whole patent, comprising the exclusive right to make, use and vend the intention throughout the United States; or (2nd) an undivided part or share of that exclusive right; or (3rd) the exclusive right under the patent within and throughout a specified part of the United States. Rev. Stat. sec. 4898.
>
> A transfer of either of these three kinds of interest is an assignment, properly speaking, investing the assignee a title and so much of the patent itself, with a right to sue infringers; in the second case, jointly with the assignor; in the first and third cases, in the name of the assignee alone. Any assignment or transfer, short of one of these, is a mere license, giving the licensee no title in the patent, and no right to sue at law in his own name for an infringement. Rev. Stat. sec. 4919; *Gaylor v. Wilder,* 51 U.S. 10 How. 477, 494, 495 [13:504,511]; *Moore v. Marsh,* 74 U.S. 7 Wall. 515 [19:37].

Waterman, 34 L.Ed. at 925.

The court in *E.I. du Pont de Nemours and Co. v. United States,* 296 F. Supp. 823 (D. Del. 1969), modified, 432 F.2d 1052 (3rd Cir. 1971), followed the "all substantial rights" test. That is, when all of the substantial rights flowing from the grant of a patent have been transferred in an agreement, then the agreement is an assignment with the corollary being that a transfer of anything less than all of the substantial rights of a patent is deemed to be a license.

JUDICIAL NOTICE

> Judicial notice should be taken of the Assignment recorded in the U.S. DEPARTMENT OF COMMERCE, United States Patent and Trademark Office, and recorded under Federal statutory law, 35 U.S.C. Sec. 152, on August 17, 1971. Such Document shows prima facie weight of the evidence that the assignment transferred "***all of the right, title and interest***" in United States Letters Patent, including transfer of ownership. App., E-1 thru E-3.
>
> Judicial Notice should further be taken that the transfer of the "all substantial rights" test follows the 100 year well settled rule of the ***Waterman*** case, the controlling precedent decided by this Court.

The lower court commits gross error in its application of *Fox Film Corp. v. Doval*, 286 U.S. 123 (1932), to this instant case, where the Supreme Court held, in clear language, that the case before the court was relative to income derived from a license and which case the lower court relies upon, where opinion states:

> "income derived from licensing of copyrights to other persons is subject to taxation by States." App., B-5, see opinion p. (4).

It is clear that *Fox Film*, at 286, is "engaged in the business of licensing copyrighted motion pictures, and that *Fox Film* brought the suit to refrain the collection of the state tax upon the gross receipts of royalties received under such licenses." And further, a property right is taxable by the state when it is held in private ownership. *Fox Film*, at 129.

The lower court further has reliance on *Fox Film* insofar as it overruled *Long v. Lockwood*, S.C. Reporter's ed. 142-151 (1928). App., B-5, see opinion p. (5).

The overruled case relates to state taxation on the net income of the patentee, computed on the manufacture and use of the patented product. *Long*, at 143.

Both *Fox Film* and *Long*, cited by the lower court and necessary to decide the constitutional federal question presented are to be deemed pure metaphor, for reason:

Long retained ownership right to patent, so likewise, *Fox Film* also retained ownership of the copyrighted movie film. Neither property right was transferred. Both *Long* and *Fox Film* transactions fail to meet the "all substantial rights" test of the *Waterman* case which governs such transfers of intellectual property. The metaphor decision of the lower court in application of *Long* and *Fox Film* to this distinguishable instant case is in clear and direct conflict with long-standing high Court precedents.

Certiorari should be granted in this case and the matter clarified where the decision below "appeared to be in conflict with our precedents." *Army & Air Force Exchange Service v. Sheehan*, 456 U.S. 728, 733 (1982).

3.

The Final, But Not Least Reason For Granting This Petition Is That The Court Of Appeals Fails To Find Any Non-Federal And *Independent And Adequate* Illinois State Law In Support Of Its Decision.

It is clear and explicit that the lower court has decided a constitutional federal question that is in direct conflict with the applicable decisions of this U.S. Supreme Court, contrary to law, and should be reversed.

Further, it is most difficult to see a tenable finding of an ***independent and adequate*** state law in support of the

lower court decision. Therefore "where there is uncertainty about what the state court did, the usual practice is to remand for clarification." *Minnesota v. National Tea Co.*, 309 U.S. 551 (1940); *California v. Krivda*, 409 U.S. 33 (1972).

CONCLUSION

For the "certworthy" reasons stated above, the Petition for Writ of Certiorari should be granted.

Respectfully submitted,

GEORGE H. BAKER, SR.

BESSIE J. BAKER
Petitioners in propria persona
4211 Simpson Drive, Meadowood
Dunlap, Illinois 61525
(309) 243-5212

APPENDICES

APPENDIX A

No. 77972

IN THE
SUPREME COURT OF ILLINOIS

GEORGE BAKER, SR., ET AL.,

Petitioners,

vs.

ILLINOIS DEPARTMENT OF REVENUE, ET AL.,

Respondents.

Motion to File Petition
for Leave to Appeal Instanter

ORDER

This cause coming to be heard on the motion of the Petitioners, due notice having been given, and the Court fully advised in the premises:

It is hereby ordered that the Petitioners' motion to file their petition for leave to appeal instanter is denied.

/s/ James D. Heiple
Justice James D. Heiple

October 13, 1994

APPENDIX B

STATE OF ILLINOIS
APPELLATE COURT
THIRD DISTRICT
OTTAWA

3-93-0823

Baker v. Dept. of Revenue

At a term of the Appellate Court, begun and held at Ottawa, on the 1st Day of January in the year of our Lord One Thousand Nine Hundred and Ninety Four, within and for the Third District of Illinois:

Present—

HONORABLE KENT SLATER, Presiding Justice

HONORABLE ALLAN L. STOUDER, Justice

HONORABLE PEG BRESLIN, Justice

HONORABLE TOM M. LYTTON, Justice ×

HONORABLE TOBIAS BARRY, Justice ×

HONORABLE MICHAEL P. MC CUSKEY, Justice ×

GIST FLESHMAN, Clerk

BE IT REMEMBERED, that afterwards on June 30, 1994 the Order of the Court was filed in the Clerk's Office of said Court, in the words and figures following viz:

"Not To Be Published"

No. 3-93-0823

IN THE
APPELLATE COURT OF ILLINOIS
THIRD DISTRICT
A.D. 1994

GEORGE H. BAKER, SR., and BESSIE JANE BAKER,
Plaintiffs-Appellants,

v.

THE DEPARTMENT OF REVENUE OF THE STATE OF ILLINOIS, RODGER D. SWEET, Director, and DEPARTMENT OF REVENUE, STATE OF ILLINOIS INCOME DIVISION, JAMES P. PIECZONKA, Administrative Law Judge,
Defendants-Appellees.

Appeal from the Circuit Court of the 10th Judicial Circuit, Peoria County, Illinois
No. 90 MR 165
Honorable John A. Barra, Judge Presiding

ORDER

The defendant, Illinois Department of Revenue (the Department) assessed additional income tax liability against the plaintiffs, George H. Baker and Bessie Jane Baker (the Bakers). The Department reached this decision after determining that the Bakers failed to report capital gains from the sale of a patent. A hearing officer reached the same conclusion after an administrative hearing. The circuit court of Peoria County affirmed the hearing officer's

decision as consistent with the manifest weight of the evidence and the law. The Bakers appeal. We affirm the judgment of the trial court.

FACTS

On January 10, 1967, the United States issued a patent to George Baker. This patent was due to expire on January 10, 1984. On June 23, 1970, the Internal Revenue Service issued a ruling (revenue ruling) in response to Baker's inquiry concerning the tax consequences of the patent's sale. According to the revenue ruling, selling the patent would constitute the sale of a capital asset, which would then entitle the Bakers to treat the sale as a long-term capital gain if held for more than six months.

In 1971, Baker sold the patent to Baker Drapery Corporation (the corporation). At the time of the sale, the Bakers owned 76% of the corporation's stock. In exchange for the patent's transfer, the corporation agreed to make annual payments to Baker for the duration of the patent. The precise amounts of these payments are not contained in the record.

On their 1984 joint federal income tax return, the Bakers reported that the patent sale resulted in a long-term capital gain of $337,569. The Bakers reported net long-term capital gains of $322,713 for 1984. Pursuant to federal tax law, the Bakers properly reduced their net capital gain by 60%, or $193,627, and listed the adjusted figure of $129,085 as part of their gross income on the tax return.

A Department audit revealed the Bakers did not report the 60% capital gain deduction as base income on their 1984 Illinois tax return. In a letter dated October 2, 1987, the Department informed the Bakers of their failure to

report the deduction as income. The Department assessed the Bakers' additional Illinois income tax liability of $5,325; accrued interest of $1,879.96; and additional interest to accrue at the rate of $1.31 per day. In a letter dated December 22, 1988, the Bakers filed a formal protest and demanded a hearing. The Department scheduled an administrative hearing for March 16, 1990.

At the hearing, the Bakers challenged the State's power to tax income derived from the sale of a patent, arguing that the Department lacked subject matter jurisdiction over the dispute. The hearing officer overruled this objection. The Department offered into evidence the Bakers' federal and Illinois income tax returns for 1984. The Department indicated that federal law allows capital gain deductions from gross income for federal tax purposes. However, Illinois law requires that any such deductions must be included in determining taxable income for State tax purposes. In response, the Bakers offered into evidence copies of the original patent and the assignment of the patent to the corporation. The Bakers offered no other evidence or argument at the hearing.

On April 27, 1990, the hearing officer agreed with the Department's decision to impose additional tax liability upon the Bakers. In his written notice of decision, the hearing officer found that the Department and the State could properly exercise subject matter jurisdiction over the dispute. With regard to the merits, the hearing officer said the Bakers' capital gain deduction of $193,627 in 1984 was apparently proper. However, Illinois law obligated the Bakers to report the capital gain deduction as income on their Illinois income tax return for the same year. The hearing officer found the Department properly determined that the Bakers were liable for an additional $5,325 in income tax plus interest.

On May 23, 1990, the Bakers filed a request for a rehearing. The Department denied this request on June 1, 1990. On July 3, 1990, the Bakers filed a complaint in the circuit court of Peoria County seeking administrative review of the Department's decision. After hearing and argument on August 13, 1993, the trial court affirmed the hearing officer's findings of fact as consistent with the manifest weight of the evidence. The court also found that the hearing officer committed no error in stating and applying the law to the facts. The trial court entered a final order of judgment for the Department on September 22, 1993. The Bakers filed a timely notice of appeal on October 22, 1993.

ANALYSIS

The Bakers' first contention is whether the income derived from the sale of a patent is subject to State taxation. We determine that the State has the power to tax such income and that this matter was properly before the Department.

The Constitution gives Congress the power to grant patents. (U.S. Const., art. I, §8.) The Supreme Court has held that income derived from the licensing of copyrights to other persons is subject to taxation by States. (*Fox Film Corp. v. Doyal* (1932), 286 U.S. 123, 131, 76 L. Ed. 1010, 1016, 52 S. Ct. 546.) In so holding, the Court stated that a patent is private property. Therefore, State taxation of that property right does *not* impermissibly burden the United States. (*Fox Film*, 286 U.S. at 128-29, 76 L. Ed. at 1014-15, 52 S. Ct. 546.) Finally, the Court said it could not draw any distinctions between the taxation of copyright royalties and the taxation of patent royalties. Consequently, the Court expressly overruled *Long v. Rockwood* (1928), 277 U.S. 142, 72 L. Ed. 824, 48 S. Ct. 463,

in which the Court had previously held that patent royalties were exempt from State income taxation. *Fox Film*, 286 U.S. at 131, 76 L. Ed. at 1016, 52 S. Ct. 546.

The Bakers argue that *Long* and *Fox Film* are distinguishable because those cases addressed the taxation of income derived from selling the *right to use* intellectual property. However, the instant case involves the taxation of income derived from the sale of the *patent itself.* We can discern no principled distinction in the case at hand. Regardless of the nature of the agreement by which the patent was used or by whom it was used, the Bakers nevertheless realized income as a result of the patent's sale. Moreover, imposing a tax on income derived from the patent's sale would not impose any burden upon the United States. Baker owned the patent and could dispose of it as he wished. Furthermore, Illinois imposes a tax on individual income. (35 ILCS 5/201(a) (West 1992).) As a result, the profit derived from the sale of the patent is subject to income taxation in Illinois. Therefore, the question of the Bakers' additional tax liability was properly before the Department.

The next issue is whether the Department applied the correct legal analysis in determining the tax consequences of the patent sale. We find no error in the Department's analysis.

A "capital asset" is defined as property held by a taxpayer, unless that property falls within any of the following categories: (1) inventory held for sale or stock in trade; (2) depreciable assets used in the taxpayer's business; (3) intellectual property held by the taxpayer; (4) accounts receivable; and (5) publications of the United States. (26 U.S.C.A. §1221 (West 1988).) Any item which does not fall within one of the five exceptions listed above is a capital asset. (*Arkansas Best Corp. v. Commissioner of*

Internal Revenue (1988), 485 U.S. 212, 217-18, 99 L. Ed. 2d 183, 189, 108 S. Ct. 971.) A "long-term capital gain" is defined as a gain realized from the sale or exchange of a capital asset held for more than six months. (26 U.S.C.A. §1222(3) (West 1988).) "Net long-term capital gain" is defined as the excess of long-term capital gains for a taxable year over the long-term capital losses for that year. (26 U.S.C.A. §1222(7) (West 1988).) In 1984, a taxpayer was entitled to deduct 60% of net long-term capital gains from his adjusted gross income. 26 U.S.C.A. §1202 (West 1984).

However, Illinois does *not* allow the deduction of capital gains from base income. Under section 203 of the Illinois Income Tax Act, capital gains reported as deductions on a federal income tax return must be added to the taxpayer's base income for Illinois income tax purposes. 35 ILCS 5/203(a)(2)(D) (West 1992).

We hold that the profits received from the patent sale were a capital asset. Baker's right to receive payments in exchange for the patent did *not* fall within any one of the five categories excepted in section 1221. The right to receive payments is not a depreciable asset used in the Bakers' trade or business. The Bakers admit this fact in the briefs they filed before the hearing officer and this court. A patent is considered to be intellectual property. However, section 1221(3) requires a patent to be *held by the taxpayer* to avoid treatment as a capital asset. Here, George Baker held only the right to receive benefits from the patent's transfer. He held no ownership rights in the patent itself after its sale. Furthermore, the Bakers reported the patent sale on their federal income tax return under the heading entitled "Long-term Capital Gains and Losses—Assets Held More Than One Year (6 months if acquired after 6/22/84)." Consequently, Baker's right to

receive payments is a capital asset under section 1221 of the Internal Revenue Code.

On their 1984 federal income tax return, the Bakers reported a net long-term capital gain of $322,713. They reduced that figure by 60%, or $193,627. They reported the balance of the gain ($129,085) as part of their adjusted gross income. Nothing in the record indicates that the Bakers reported their income improperly on their federal return. The revenue ruling indicates that any gain from the patent sale could properly be considered as a capital gain. However, the Department's audit demonstrates the Bakers failed to report the 60% deduction as an addition to base income on their Illinois income tax return as required by section 203(a)(2)(D). As a result, the Department imposed additional tax liability upon the Bakers. Based upon our review of the applicable law, we conclude that the Department applied the correct law in analyzing the tax consequences of the patent sale.

The Bakers next argue that the Department used incorrect legal principles in determining their tax liability. In support of their contentions, they advance four essential arguments. We shall address each in turn.

First, the Bakers correctly point out that under federal law, patents are considered personal property. (35 U.S.C.A. §261 (West 1984).) They also note that the Illinois Constitution abolishes personal property taxes. (Ill. Const. 1970, art. IX, §5(c).) Based on these provisions, the Bakers conclude that the State may not levy any tax on a patent. However, the tax at issue in this case is not imposed upon the patent as personal property. Rather, the tax is imposed upon the income received as a result of the patent's sale. Thus, we find no merit to this contention.

Second, the Bakers argue that as the owner of the patent, only the corporation incurs tax liability for the use

and benefits of the patent. The Bakers contend they owe no taxes on the patent sale because they hold no ownership interests in the patent. We find no merit to this argument. As part of the contract for sale, George Baker retained a right to receive income from the corporation during the life of the patent, though he sold the patent itself to the corporation. Based upon this intangible personal property right, the Bakers realized a gain which they reported on their federal income tax return in 1984. Since the Bakers took a long-term capital gain deduction for that year, they were required to add the deduction amount to their base income for Illinois income tax purposes.

Third, the Bakers claim the gain from the patent sale should have been considered "ordinary income" for Illinois income tax purposes. Section 1239 of the Internal Revenue Code sets forth the prerequisites for treatment as ordinary income. The property sold or exchanged must be a depreciable asset and the sale must be between related persons. (26 U.S.C.A. §1239(a) (West 1988).) The statutory provision in effect in 1984 defined "related persons" as an individual and a corporation in which the individual owns *at least 80%* of the outstanding stock. 26 U.S.C. §1239(b)(2) (1984).

The Bakers' contention is misguided for two reasons. Initially, the corporation did not qualify as a "related person" under section 1239(a). Here, the Bakers owned only 76% of the corporation's stock. Furthermore, if the gain qualified for ordinary income under section 1239(a), the Bakers would not have been entitled to the capital gain deduction on their federal income tax return. The Department does not contend that the Bakers improperly treated the income as a deductible capital gain of their federal return. The revenue ruling establishes that any gain realized from the sale of the patent qualified for long-term

capital gain treatment. In addition, the Bakers characterized the income received from the patent sale as a long-term capital gain on their federal income tax return. Accordingly, we conclude that the Bakers' argument on this issue is without merit.

Fourth, the Bakers argue that the sale price of the patent constituted a valuation limitation amount for the purpose of computing their Illinois income tax liability. All valuation limitation amounts, like net capital gains, must be added to a taxpayer's base income for Illinois income tax purposes. (35 ILCS 5/203(a)(2)(G) (West 1992).) This argument lends no support to the Bakers' ultimate contention that the patent sale does not result in tax liability. Even if the sale price was a valuation limitation, section 203(a)(2)(G) would still have required the Bakers to add the amount to their base income. This method of tax treatment would have resulted in the identical computation of tax liability now imposed upon the Bakers.

The Bakers assert the value of the patent is the cash value, i.e. the price upon which a willing buyer and seller agree. (*Consolidation Coal Co. v. Property Tax Appeal Board* (1975), 29 Ill. App. 3d 465, 468, 331 N.E.2d 122, 126.) While the Bakers have stated the principle correctly, *Consolidation Coal* in no way supports exemption from income taxation for the sale of a patent. The *Consolidation Coal* case addresses the proper methods of assessing the value of certain items of personal property. That case does not address the tax consequences of these assessments under the Internal Revenue Code or the Illinois Income Tax Act. As a result, we conclude that the Department and the trial court applied the correct legal principles in finding the Bakers liable for additional income taxes in 1984.

Additionally, the Bakers contend that the Department's decision is against the manifest weight of the evidence. We disagree with this argument.

A court's function in reviewing an administrative agency's decision is to ascertain whether the agency's factual findings and decision are against the manifest weight of the evidence. (*Abrahamson v. Illinois Department of Professional Regulation* (1992), 153 Ill. 2d 76, 88, 606 N.E.2d 1111, 1117.) Part of the court's function is to determine whether the record contains enough evidence to support the agency's findings. (*Clark v. Board of Fire & Police Commissioners* (1993), 245 Ill. App. 3d 385, 392, 613 N.E. 2d 826, 830.) An agency's factual findings are considered to be *prima facie* true and correct. (735 ILCS 5/3-110 (West 1992); *Dillavou v. County Officers Electoral Board* (1994), ____ Ill. App. 3d ____, ____, 632 N.E.2d 1127, 1132.) An agency's decision is contrary to the manifest weight of the evidence only if no rational trier of fact could have agreed with the agency's decision. *Farmers State Bank v. Department of Employment Security* (1991), 216 Ill. App. 3d 633, 640, 576 N.E.2d 532, 537.

Following our thorough review of the record, we agree with the trial court that the decision to assess additional tax liability upon the Bakers was consistent with the manifest weight of the evidence. In his written decision, the hearing officer made findings of fact based upon the evidence which the Department presented. First, the officer found that the dispute was properly before the Department. Second, the Bakers reported the profits from the patent sale as a long-term capital gain and made the appropriate deduction on their federal income tax return. Third, the Bakers did not report the amount of the deduction as income on their Illinois income tax return. The Bakers presented no evidence to refute these findings of

fact. Accordingly, we conclude that a rational trier of fact could have arrived at similar findings. The evidence presented was sufficient to support the agency's findings.

Finally, the Bakers argue that they owned only 16% of the corporation's stock. The Department hearing officer found that they owned more than 25% of the stock. The Bakers contend that the facts do not support the hearing officer's conclusion. To support their contention, the Bakers refer to an argument contained in a brief filed with the Department during the early stages of this dispute. They have not directed us to, nor can we find, any evidence or proof in the record which indicates that the Bakers owned only 16% of the corporation's stock. On the other hand, the revenue ruling indicates that in 1970, the Bakers owned 76% of the stock. Based upon the revenue ruling, the officer was justified in finding that the Bakers owned more than 25% of the stock.

CONCLUSION

In summary, we conclude that this dispute was properly before the Department. Based upon our review of the record, we find the trial court was correct in holding that the Department's decision was not contrary to the law or the manifest weight of the evidence. For the reasons indicated, the judgment of the circuit court of Peoria County is affirmed.

Affirmed.

McCUSKEY, J., with BARRY and LYTTON, JJ., concurring.

[Certificate of Clerk omitted in printing.]

APPENDIX C

[Filed September 22, 1993]

IN THE CIRCUIT COURT OF THE
TENTH JUDICIAL CIRCUIT OF ILLINOIS
PEORIA COUNTY

Case No. 90-MR-165

GEORGE H. BAKER, SR., and BESSIE JANE BAKER,
Plaintiffs,

vs.

THE DEPARTMENT OF REVENUE OF THE STATE OF ILLINOIS, RODGER D. SWEET, Director, and THE DEPARTMENT OF REVENUE OF THE STATE OF ILLINOIS, Income Tax Legal Division, JAMES P. PIECZONKA, Administrative Law Judge,
Defendants.

ORDER

This matter comes before the Court on administrative review, and the Court, having reviewed the record and the briefs of parties, FINDS:

1. The decision of the Department of Revenue is not against the manifest weight of the evidence; and
2. The decision of the Department of Revenue is not contrary to the law.

The decision of the Department of Revenue is affirmed.

Judgment is entered in the amount of $9,467.00 against the Bakers.

The Clerk is ordered to mail a copy of this order to the persons listed below.

ENTERED: 9/22/93

/s/ John A. Barra
Circuit Court Judge

CC: John Simpson, AGA
George H. Baker
Bessie Jane Baker

APPENDIX D

[Dated April 27, 1990]

ILLINOIS DEPARTMENT OF REVENUE
ADMINISTRATIVE HEARINGS DIVISION
STATE OF ILLINOIS CENTER
100 W. RANDOLPH STREET, LEVEL 7
CHICAGO, ILLINOIS 60601

DEPARTMENT OF REVENUE
OF THE STATE OF ILLINOIS

v.

George H. and Bessie J. Baker

Taxpayer

Docket #
SSN/FEIN # 347-14-8795
For Tax Years Ended:
12/31/84
Deficiency Amount: $5,325.00

NOTICE OF DECISION

TO: George H. and Bessie J. Baker
4211 Simpson Dr.
Meadowood Subdivision
Dunlap, Illinois 61525

YOU ARE HEREBY NOTIFIED that the attached recommended decision of the Administrative Hearings Division in the above entitled cause has been accepted by the Director of Revenue as dispositive of the issues therein.

Unless you otherwise request a rehearing pursuant to the provisions of Section 908(c) of the Income Tax Act, this determination shall become a final administrative decision 30 days from the date of issuance. Following expiration of the 30 days, or after issuance of a denial of rehearing, should one be requested, you may pursue your rights to administrative review by filing a complaint in the circuit court under the requirements of Ill. Rev. Stat. ch. 110, Sec. 3-101 et seq.

April 27, 1990
Date of Issuance

/s/ Roger D. Sweet, Director
Illinois Department of Revenue

JPP:mh

I. JURISDICTION:

Tax Year	Notice of Deficiency	Protest Due	Protest Filed
12/31/84	10/2/87	11/16/87	10/15/87* 12/22/88

II. ISSUES:

1. Whether Taxpayers are liable for additional income taxes due to an increase in their adjusted gross income pursuant to a Federal Tape Match and failure to report an addition modification in the amount of $193,627 as reported on their U.S. 1040 Schedule "D", Line 22 (60% capital gain deduction).

2. Whether Taxpayers' filing dated October 15, 1987 was a timely protest.

III. FINDINGS OF FACT:

1. Taxpayers, George H. and Bessie J. Baker reported installment payments on Schedule "D", Line 9 of their 1984 U.S. 1040, an installment from the sale of a patent in the amount of $337,569.00. Additionally, Taxpayer reported a 60% capital gain deduction in the amount of $193,628 on Line 22 of Part III of their U.S. 1040 return for 1984 (DOR Ex. No. 5).

2. Taxpayers failed to report on their 1984 IL-1040 the capital gain deduction reported federally in 1984 in the amount of $193,627.00 (DOR Ex. No. 5).

3. On October 2, 1987, the Department timely issued a Notice of Deficiency to Taxpayers pursuant to a Federal Tape match and stating that Taxpayers failed to report as an addition modification the 60% federal capital gain deduction in the amount of $193,627.00.

The resultant tax was proposed at $5,325.00 (DOR Ex. No. 3).

4. On October 15, 1987, the Department received an "Answer to Notice" from Taxpayers. Said answer stated that the patent transferred to Taxpayer by the U.S. government in 1971 by assignment was an I.R.C. Section 1221 capital asset and governed by Section 453. Consequently, the proposed assessment is exempt from Illinois tax under Chapter 120, Section 203(a)(2)(N). Additionally, said answer did not request a hearing (DOR Ex. No. 4).

5. On June 24, 1988, in a letter to Tax Analyst, Stephen J. Giannangelo; Taxpayer, George Baker, admitted that his patent was intangible personal property, however, it was not property used in Taxpayer's trade or business under Section 1231 nor of a character subject to depreciation under Section 167, real property under Section 1221(2) or property included in the inventory of Taxpayer under Section 453(b)(1)(B) (DOR Ex. No. 5).

6. The IRS Revenue Ruling dated June 23, 1983 addressed to Taxpayer concluded that any gain from the sale of the patent realized by Taxpayer constitutes a sale of a capital asset as provided in Section 1221 and is treated as long term capital gains within Section 1222(3) (DOR Ex. No. 5).

7. On December 22, 1988, Taxpayer filed a request for hearing to the subject Notice of Deficiency stating that he had no items of tax modification add back on his IL-1040 return for 1984 (DOR Ex. No. 4).

8. On March 16, 1990, a hearing was held before Administrative Law Judge, James P. Pieczonka, at the Department's offices in Peoria, Illinois. Staff-Attor-

ney, John Doherty introduced DOR Exhibits 1-7 as the Department's prima facie case (DOR Ex. Nos. 1-7). Taxpayers, George and Bessie Baker appeared with their son George Baker, Jr. and without counsel (Tr. p. 1-3; DOR Ex. No. 1).

9. Taxpayer contested the jurisdiction of the State by a special and limited appearance, not generally, based upon lack of jurisdiction over the subject matter, the U.S. Patent (Tr. p. 4-9).

10. The Administrative Law Judge denied Taxpayer's motion to dismiss for lack of subject matter jurisdiction (Tr. p. 10-12).

11. Taxpayer denied that his letter dated October 15, 1987 was his protest (Tr. p. 15), however, the letter dated December 22, 1988 was his protest which requested a hearing (Tr. p. 17-21). Subsequent to Taxpayers December 22, 1988 protest, the Department transferred Taxpayer's case to the hearing division (Tr. p. 21; DOR Ex. No. 5).

12. Taxpayers objection to admission of DOR Exhibits 1-7 based upon lack of subject matter jurisdiction was denied (Tr. p. 23).

13. Taxpayer, George Baker Sr. was called as an adverse witness, however, he refused to testify (Tr. p. 23-26).

14. Taxpayer submitted a copy of the subject patent No. 3296651 as Taxpayer Exhibit No. 1 (Taxpayer Ex. No. 1).

15. The Administrative Law Judge finds that the substance of the document filed by Taxpayer on October 15, 1987 was a sufficient and timely protest.

16. The Administrative Law Judge finds that the State of Illinois has jurisdiction of the Taxpayers and subject matter, the addition modification of Taxpayers U.S. capital gain deduction from the sale of the subject patent pursuant to Chapter 120, Ill. Rev. Stat. Section 203(a)(2)(B).

17. Finally, Administrative Law Judge finds that Taxpayer failed to report as an addition modification on their IL-1040 return for 1984, the 60% capital gain deduction in the amount of $193,627.00 as reported on their 1984 U.S. 1040 return.

IV. DISCUSSION OF LAW AND FACTS:

Section 203(a)(2)(b) of the Illinois Income Tax Act provides:

> That an addition modification must be made to an individuals federal adjusted gross income for "an amount equal to the amount of deduction allowable under Section 1202 of the Internal Revenue Code (Code) to the extent deduction from gross income in the computation of AGI."

Ch. 120, Ill. Rev. Stat. Section 203(a)(2)(B).

The instant case involves the 1984 income tax treatment of an installment sale by the creator or inventor (the Taxpayer in this case) of a United States Letters Patent and a Canadian Patent. Taxpayers did not add back to Illinois a 60% capital gain deduction reported on their federal 1040 return for 1984.

Section 203(a)(2)(B) of the Illinois Income Tax Act (Act) in effect during this taxable year requires the following addition modification to be made to an individual's federal adjusted gross income (AGI): "an amount equal to the amount of deduction allowable

under Section 1202 of the Internal Revenue Code (Code) to the extent deducted from gross income in the computation of AGI." Section 1202 of the Code as in effect in 1984 stated: "if for any taxable year a Taxpayer other than a corporation has a net capital gain, 60% of the amount of the net capital gain shall be a deduction from gross income." This capital gain deduction was allowed in Part III, line 22 of Schedule D of Taxpayer's federal individual income tax return for 1984.

Since Taxpayers deducted an amount on the above line for 1984 federally, it must be added back to AGI on his Form IL-1040. In general, under Section 1235 of the Code, a patent holder is specifically allowed capital gain treatment on the sale or exchange of a patent or of an undivided interest in patent rights. Thus, the sale or exchange of patents are generally considered to be that of the sale or exchange of a capital asset. Because the sale was apparently made to a related taxpayer in Mr. Baker's situation (Baker Drapery Corporation—a corporation in which taxpayer owned more than 25% of the voting stock within the meaning of 1235(d)), this specific rule for the treatment of sales and exchanges of patents probably would not apply in this case.

However, in Mr. Baker's case, for federal tax purposes, he *did* realize and *did* recognize a long term capital gain (as that term is defined in Section 1222(3) of the Code) on the sale of his patent. This long term capital gain was apparently determined under the treatment provided for in Section 1231(a) of the Code, not Section 1235. Regardless of whether Section 1235 is applicable to this case, the Department properly added backed the capital gain deduction as

a modification to Mr. Baker's base income on his 1984 IL-1040. He had correctly reported the gain on Schedule D of his federal return and then took the deduction (for which has was entitled) of 60% of the recognized capital gain.

In his prior correspondence with the Department, Mr. Baker's citing of Section 1221 of the Code in support of his position is incorrect. As clarified in the 1988 U.S. Supreme Court opinion in *Arkansas Best v. Commissioner*, 108 C.Ct. 971, Section 1221 of the Code defines capital assets by listing specific categories which are *not* capital assets. All assets that do not fall within those categories *are* capital assets. Taxpayer's patent does not fall under any of the five narrow exceptions in Section 1221. As a result, the intangible personal property at issue here would fall under the general definition of a capital asset contained in Section 1221 as "property held by the taxpayer."

The Sections of the Act cited by Mr. Baker in prior correspondence do not support his position either. The sale of the patent is not exempt from Illinois income taxation under Section 203(a)(2)(N) of the Act, since Taxpayers are domiciled in Illinois neither Section 303(b)(3) or 303(d)(2)(A) of the Act would not allow the sale to be allocable to any state other than Illinois.

In conclusion, the 60% capital gain deduction reported on Taxpayers' Federal 1040 return for 1984 must be added back into Taxpayers' AGI on their IL-1040 return as corrected by the Department, therefore, the deficiency must stand in its entirety.

V. DECISION:

It is the decision of the Director of Revenue that the Notice of Deficiency shall stand and Taxpayers are liable for the following taxes:

COMPUTATION:

	Tax Year Ended
	12/31/84
1. Adjusted Gross Income	$ 35,766.00
2b. Capital Gain Deduction	193,627.00
4a. Illinois Property Tax Paid	2,553.00
4g. Other Subtractions	87.00
6. Exemptions	2,000.00
Tax @ 2¾%	6,181.00
Total IL-1040 Withheld	464.00
Total Payments & Credits	464.00
15. Balance Due	5,717.00
16. Tax Paid With Original Return	392.00
20. Balance Due	$ 5,325.00

/s/ James P. Pieczonka
Administrative Law Judge

JPP:mh/1260

APPENDIX E

U.S. DEPARTMENT OF COMMERCE
United States Patent and Trademark Office

April 9, 1987
(Date)

THIS IS TO CERTIFY that the annexed is a true copy from the records of this office of a Document recorded August 17, 1971.

By authority of the
COMMISSIONER OF PATENTS
AND TRADEMARKS

/s/ Diane G. Russell
Certifying Officer.

ASSIGNMENT

WHEREAS, on May 26, 1971, GEORGE H. BAKER, SR., Dunlap, Illinois, and BAKER DRAPERY CORPORATION, a Delaware corporation having a place of business at 1116 Pioneer Parkway, Peoria, Illinois 61614, entered into a Patent Assignment Agreement; and

WHEREAS, said Patent Assignment Agreement was executed in three and only three duplicate originals, with no copies, and the plates and film with which the originals were printed have been destroyed; and

WHEREAS, one each of the originals is in the possession of GEORGE H. BAKER, SR., BAKER DRAPERY CORPORATION and RICHARD S. PHILLIPS of Hofgren, Wegner, Allen, Stellman & McCord, 20 North Wacker Drive, Chicago, Illinois 60606.

NOW, in furtherance of and subject to the rights and obligations of said Assignment Agreement, GEORGE H. BAKER, SR. assigns to BAKER DRAPERY CORPORATION all of the right, title and interest in United States Letters Patent 3,296,651 and Canadian patent 770,972.

/s/ George H. Baker, Sr.

STATE OF ILLINOIS
COUNTY OF PEORIA—ss.

Before me, a Notary Public in and for the County and State aforesaid, appeared GEORGE H. BAKER, SR., to me personally known to be the same person whose name is subscribed to the foregoing instrument, and acknowledged that he executed said instrument as his free and voluntary act and for the uses and purposes therein expressed this 10th day of August, 1971.

/s/ _____ Griffin
Notary Public

RECORDED
U.S. PATENT OFFICE
AUG 17 1971